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No. 00-1545

In the Supreme Court of the United States

GARY K. BIELFELDT AND CARLOTTA J. BIELFELDT,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the trading by petitioner in United States Treasury securities resulted in capital losses or ordinary losses.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-7) is reported at 231 F.3d 1035. The opinion of the Tax Court (Pet. App. 8-42) is unofficially reported at 76 T.C.M. (CCH) 776.

JURISDICTION

The judgment of the court of appeals was entered on November 8, 2000. The petition for rehearing was denied on January 8, 2001. Pet. App. 48. The petition for a writ of certiorari was filed on April 6, 2001. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Between 1985 and 1989, petitioner Gary K. Bielfeldt traded Treasury securities through Bielfeldt & Co., a partnership in which he held a partnership interest.[1] Treasury securities are initially sold through auctions conducted by the Department of the Treasury. Pet. App. 12. Between the date of announcement of an upcoming auction and the issuance of securities after the auction Treasury securities are traded on a "when-issued" basis. *Id.* at 13 n.3. After their issuance, Treasury securities are traded predominantly in an over-the-counter market that is comprised of a network of dealers, brokers and investors who effect transactions in the securities over the telephone. *Id.* at 12-13. Petitioner traded primarily with "primary dealers," which are the firms designated by the Federal Reserve Bank of New York to deal with the Federal Reserve in the Treasury securities market. *Id.* at 20-22. The issue in this case is whether petitioner's transactions in these securities gave rise to capital losses or ordinary losses.

Section 1221 of the Internal Revenue Code generally defines a "capital asset" as "property held by the taxpayer (whether or not connected with his trade or business) * * *." 26 U.S.C. 1221. The statute specifies, however, that this term does not include (26 U.S.C. 1221(1)):[2]

> stock in trade of the taxpayer or other property of a kind which would properly be included in the

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[1] Petitioner's wife, Carlotta J. Bielfeldt, is a party to this case solely because she filed joint federal income tax returns with her husband during the relevant taxable years.

[2] This statute was redesignated as 26 U.S.C. 1221(a)(1) (Supp. V 1999) by the Tax Relief Extension Act of 1999, Pub. L. No. 106-170, § 532(a)(1)-(3), 113 Stat. 1928-1930.

inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

On his federal tax returns for the years 1985 to 1989, petitioner initially took the position that his transactions in Treasury securities gave rise to capital gains and capital losses. Pet. App. 10. Petitioner subsequently filed amended returns for those years, however, that took the position that these transactions gave rise to ordinary income and ordinary losses. *Id.* at 11. If these trading losses were properly recharacterized from capital to ordinary losses, petitioner would be allowed to use the net trading losses incurred in these years to offset ordinary income from other sources he reported in these and other years.[3] *Ibid.* Based on the theory that these losses were ordinary rather than capital in nature, petitioner claimed tax refunds of $3,202,380 for 1984, $19,781,480 for 1985, $39,160,798 for 1986, $16,232,812 for 1987, and $6,658,075 for 1988. *Ibid.*

The Commissioner of Internal Revenue disallowed the refund claims and asserted deficiencies in tax and additions to tax against petitioner for the years 1984 through 1988. Petitioner challenged these determinations in Tax Court and also sought the refunds claimed on his amended returns.

2. The Tax Court held that petitioner incurred capital, rather than ordinary, losses from his trading in

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[3] As the court of appeals explained (Pet. App. 2), this would occur because the Internal Revenue Code generally allows ordinary losses to be offset against ordinary income in their entirety but precludes an individual taxpayer from deducting more than $3000 in capital losses from ordinary income. See 26 U.S.C. 1211(b).

Treasury securities. Pet. App. 28-42. The court initially rejected petitioner's contention that the Treasury securities he traded were part of his "stock in trade or inventory" within the meaning of Section 1221(1). The court explained that "courts have consistently held [that] securities may be classified as stock in trade or inventory only when they are held primarily for sale to customers in the ordinary course of business." *Id.* at 30. The court noted that Congress added the phrase "to customers" to the predecessor of Section 1221(1) for the express purpose of making "it 'impossible to contend that a stock speculator trading on his own account is not subject to the [capital loss limitation] provisions.'" *Id.* at 31 (quoting H. R. Conf. Rep. No. 1385, 73d Cong., 2d Sess. 22 (1934)).

The Tax Court also rejected petitioner's contention that he had sold Treasury securities "to customers" within the meaning of Section 1221(1). The court observed that "whether an individual sells securities to customers is a question of fact that hinges on his or her classification as a dealer, trader, or investor" and that "only a dealer is eligible for the section 1221(1) exception because only a dealer has customers." Pet. App. 31. The court concluded that petitioner was not a dealer in Treasury securities because "he did not conduct his trading activity in the manner in which a dealer would have," because "his primary intent in trading Treasury securities was inconsistent with that of a dealer," because he dealt only with "primary dealers" rather than with customers, because he "did not perform any merchandising functions or any other services * * * indicative of a trader," because he "did not consider himself a dealer during the relevant time" and because he "did not register" or advertise as a dealer. *Id.* at 31-38.

3. The court of appeals affirmed. Pet. App. 1-7. The court held that petitioner was a "speculator," and not a "dealer," for federal tax purposes. *Id.* at 5-6. The court noted that petitioner (*ibid.*):

> hoarded Treasury securities during the fat weeks immediately after an auction so that there would be an adequate supply in the lean weeks (the weeks between auctions) that followed. That activity may have been socially beneficial, as he argues, but it is no different from the social benefits of speculation generally. His argument if accepted would turn every speculator into a dealer for purposes of the Internal Revenue Code.

The court of appeals also rejected petitioner's contention that he incurred ordinary losses from his transactions in Treasury securities because the function he performed was analogous to the function performed by a "floor specialist" on a stock exchange (Pet. App. 6):

> Unlike a floor specialist, [petitioner] undertook no obligation to maintain an orderly market in Treasury securities. He did not maintain an inventory of securities; and because he skipped auctions that didn't seem likely to produce the glut that was the basis of his speculative profits, there were months on end in which he could not have provided liquidity by selling from inventory because he had no Treasury securities. * * * He was a speculator, period. As the Federal Reserve Bank of New York, which kept track of [petitioner's] trading in Treasury securities and sent updates to the IRS, put it, "his activities are in most cases outright speculation on interest rate movements."

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. a. The Internal Revenue Code generally allows a deduction from gross income for "any loss sustained during the taxable year and not compensated for by insurance or otherwise." 26 U.S.C. 165(a). There is an exception from that general rule, however, for losses that result from the sale or exchange of "capital assets." 26 U.S.C. 165(f). Such "capital" losses may be deducted "only to the extent allowed in sections 1211 and 1212." 26 U.S.C. 165(f). Under Section 1211(b) of the Code, losses from sales or exchanges of "capital assets" by an individual taxpayer are "allowed only to the extent of the gains from such sales or exchanges, plus * * * the lower of $3,000 * *-* or the excess of such losses over such gains." 26 U.S.C. 1211(b). In other words, an individual taxpayer may deduct a maximum of $3000 in capital losses from his ordinary income for a particular year.

The Code generally defines a "capital asset" for this purpose as "property held by the taxpayer (whether or not connected with his trade or business) * * *." 26 U.S.C. 1221. This term, however, expressly does not include (26 U.S.C. 1221(1)):

> stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

Losses from the sale or exchange of property encompassed by Section 1221(1) are generally deductible in full from ordinary income (pursuant to Section 165(a) of the Code).

b. In interpreting the phrase "property held * * * primarily for sale to customers" in Section 1221(1), courts consistently have drawn a distinction between "dealers" who keep a supply of securities on hand for resale to customers (and derive ordinary income and ordinary losses from their transactions) and "traders" who trade in securities for their own accounts (and derive capital gains and capital losses from their transactions). See, *e.g.*, *Marrin* v. *Commissioner*, 147 F.3d 147, 151 (2d Cir. 1998); *Mirro-Dynamics Corp.* v. *United States*, 374 F.2d 14, 16 (9th Cir.), cert. denied, 389 U.S. 896 (1967); *Gruver* v. *Commissioner*, 142 F.2d 363, 368 (4th Cir. 1944); *Commissioner* v. *Burnett*, 118 F.2d 659, 660 (5th Cir. 1941).[4] As the court of appeals correctly explained in this case (Pet. App. 2):

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[4] Petitioner errs in asserting (Pet. 17-18) that the decision in this case "creates a direct and irreconcilable conflict between the Seventh Circuit and the specific decisions of this Court in *Arkansas Best Corp. v. Commissioner*, 485 U.S. 212 (1988), and *Corn Products Ref. Co. v. Commissioner*, 350 U.S. 46 (1955)." The issues addressed in those cases were not even remotely related to the issue presented in this case. Those cases concerned the extent to which ordinary or capital gains or losses resulted from (i) a taxpayer's acquisition of commodity futures as a "hedge" against future business needs for that commodity (*Corn Prods.*, 350 U.S. at 51-52) or (ii) a company's acquisition of bank stock for the purpose of protecting that company's business reputation (*Arkansas Best*, 485 U.S. at 215). Neither of those decisions dealt with the question addressed in this case. As we have noted in the text, the courts that *have* addressed the question addressed here have uniformly held that securities speculators such as petitioner cannot claim ordinary losses from their transactions.

> The standard distinction between a dealer and a trader is that the dealer's income is based on the service he provides in the chain of distribution of the goods he buys and resells, rather than on fluctuations in the market value of those goods, while the trader's income is based not on any service he provides but rather on, precisely, fluctuations in the market value of the securities or other assets that he transacts in.

Accord, *e.g*, *Marrin* v. *Commissioner*, 147 F.3d at 151; *United States* v. *Wood*, 943 F.2d 1048, 1051 (9th Cir. 1991); *Stephens, Inc.* v. *United States*, 464 F.2d 53, 57 (8th Cir. 1972), cert. denied, 409 U.S. 1118 (1973).

c. The record of this case amply supports the Tax Court's factual determination (Pet. App. 30-42) that petitioner was a trader, and not a dealer, in Treasury securities during the relevant taxable period. For example, the record establishes that (i) petitioner personally owned all of the Treasury securities that he traded and traded those securities only for his own account (*id.* at 33-34), (ii) petitioner did not earn a commission on any of his trades and did not effectuate trades pursuant to a directive from any customer (*id.* at 34), (iii) petitioner did not treat other parties as customers (*ibid.*), (iv) petitioner did not perform any merchandising functions (*id.* at 36-37) and (v) petitioner did not consider himself a dealer, or register as a dealer, during the relevant time period (*id.* at 37-38). Based upon this factual record, the court of appeals concurred in the Tax Court's finding that petitioner acted as a trader, rather than a dealer, and therefore did not incur ordinary losses from his trading in Treasury securities.[5]

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[5] Petitioner erroneously refers to himself as a "specialist" (Pet. 6, 20). The Seventh Circuit correctly observed (Pet. App. 6) that

That factual determination, which was "concurred in by two lower courts" (*Rogers* v. *Lodge*, 458 U.S. 613, 623 (1982)), does not warrant review by this Court. See *Tiffany Fine Arts, Inc.* v. *United States*, 469 U.S. 310, 317-318 n.5 (1985).

2. Petitioner nonetheless asserts (Pet. 8-17) that the court of appeals erred by not overturning the allegedly erroneous legal conclusion of the Tax Court that securities can constitute "stock in trade" under 26 U.S.C. 1221(1) only if they are held primarily for sale to customers. The premise underlying that argument—that securities traded by an individual who has no customers and trades exclusively for his own account can be part of his "stock in trade" within the meaning of Section 1221(1)—is at odds with common sense and with the language and legislative history of the statute. It is also refuted by the overwhelming and unanimous body of case law. *Van Suetendael* v. *Commissioner*, 152 F.2d 654 (2d Cir. 1945) (securities "could not be classified as stock in trade or property subject to inventory unless they were held by the taxpayer primarily for sale to customers in the ordinary course of his business"); see also *Swartz* v. *Commissioner*, 876 F.2d 657, 659 (8th Cir. 1989), cert. denied, 494 U.S. 1006 (1990); *Mirro-Dynamics Corp.* v. *United States*, 374 F.2d at 16.

The term "stock in trade" is generally defined as "[t]he inventory carried by a retail business for sale in the ordinary course of business." *Black's Law Dictionary* 1418 (6th ed. 1990). The term properly encompasses the supply of securities maintained by a taxpayer to take care of future buying orders in excess of

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petitioner did not engage in any activities that were comparable to the activities performed by a "specialist" on a stock exchange.

selling orders. Because "stock in trade" is part of the "inventory" of a business, however, the term obviously cannot encompass securities that are traded by an individual who has no customers and trades exclusively for his own account. *United States* v. *Nordberg*, 96-1 U.S. Tax. Cas. (CCH) ¶ 50,295, at 84,088 (D. Mass.) ("A taxpayer without customers likewise cannot satisfy the first clause of § 1221(1) to wit, hold the securities as 'stock in trade . . . which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year.'"), aff'd, 97 F.3d 1445 (1st Cir. 1996), cert. denied, 519 U.S. 1078 (1997). Securities traded by a taxpayer for his own account are not part of his business inventory for federal tax purposes. *Mirro-Dynamics Corp.* v. *United States*, 374 F.2d at 16. Treasury regulations make this clear by specifying that only a dealer in securities may hold unsold securities as inventory. 26 C.F.R. 1.471-5. The regulations further define a "dealer in securities" as (*ibid.*):

> a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers; that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. * * * Taxpayers who buy and sell or hold securities for investment or speculation, irrespective of whether such buying or selling constitutes the carrying on of a trade or business, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this section. * * *

Petitioner was not a merchant of Treasury securities because he bought and sold these securities solely for speculative purposes. These securities thus cannot form "stock in trade" within the meaning of Section 1221(1).

The legislative history of the governing statutory provisions confirms that petitioner's transactions are capital rather than ordinary in nature. Prior to 1934, the revenue statutes had provided that:

> [t]he term 'capital assets' means property held by the taxpayer for more than two years (whether or not connected with his trade or business) but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business.

Revenue Act of 1926, ch. 27, § 208(a)(8), 44 Stat. 19. In the Revenue Act of 1934, ch. 277, § 117(b), 48 Stat. 714, Congress added the phrase "to customers" to the term "property held by the taxpayer primarily for sale" in order "to prevent tax avoidance by making it abundantly clear that a stock speculator buying and selling securities for his own account and not for resale to customers was subject to the limitation on the deductibility of capital losses provided in § 117 of the Act." *Gruver* v. *Commissioner*, 142 F.2d 363, 368 (4th Cir. 1944). See H.R. Conf. Rep. No. 1385, *supra*, at 22; *Marrin* v. *Commissioner*, 147 F.3d at 151. Petitioner is precisely the type of large speculator who buys and sells securities for his own account that the 1934 amendment ensured would be subject to the capital loss limitation provisions of Section 1221.

Petitioner errs in asserting (Pet. 9-10) that *Gilbert* v. *Commissioner*, 56 F.2d 361 (1st Cir. 1932), supports a different conclusion. In that case, the court of appeals held that certain stock owned by a taxpayer was not a capital asset under the pre-1934 version of Section 1221(1). In reaching that conclusion, the court reasoned that the stock was "held by the taxpayer primarily for sale in the course of his trade or business" within the meaning of the pre-1934 version of the statute. *Id.* at 362. That decision, however, was plainly based upon the text of the statute before it was amended for the very purpose of precluding speculators such as petitioner who buy and sell securities on their own account from claiming ordinary losses from their activities. See *Gruver* v. *Commissioner*, 142 F.2d at 368; page 11, *supra*. Because the decision in *Gilbert* is not based upon the same statutory language involved in the present case, it cannot be said to conflict with the decision in this case.

3. We do not agree with petitioner's suggestion that the decision in this case will have an adverse impact on "the efficient working of the Treasury cash market" (Pet. 19). There is no evidence in this record—or any other evidence of which we are aware—to suggest that applying the same tax rules to petitioner that have long applied to all other securities speculators will have any adverse effect on the market for Treasury securities. The court of appeals stressed that it was not addressing the tax treatment of a trader in Treasury securities who (unlike petitioner) conducted activities that resemble those of a floor specialist on a stock exchange. Pet. App. 6. Nothing in the narrow and fact-specific decision in this case will place the ordinary and efficient marketing of Treasury securities at risk.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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